



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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In the Matter of Application of  
CALIFORNIA-AMERICAN WATER  
SERVICE COMPANY (U 210 W) for an  
order authorizing it to increase its rates for  
water service in its Los Angeles District to  
increase revenues by \$2,020,466 or 10.88% in  
the year 2007; \$634,659 or 3.08% in the year  
2008; and \$666,422 or 3.14% in the year  
2009.

A.06-01-005  
(Filed January 9, 2006)

**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES  
ON PHASE ONE PROPOSED DECISION**

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May 29, 2007

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**I. INTRODUCTION**

Pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure (Rules), the Division of Ratepayer Advocates (DRA) submits these Comments on the 5/7/07 Proposed Decision adopting the revenue requirement for California-American Water Company's (Cal-Am's) Los Angeles District (Proposed Decision or PD).

DRA supports many aspects of the Proposed Decision, including:

- Adopting the partial settlement between DRA and Cal-Am on certain revenue requirement issues.
- Establishing a return on equity (ROE) of 10.0%.
- Adopting a reduction in ROE of .50% if the Commission implements certain accounting mechanisms (Water Revenue Adjustment Mechanisms and Modified Cost Balancing Accounts) in conjunction with the conservation rate design being considered in Phase II.
- Requiring certain limitations and customer safeguards as part of the Distribution System Infrastructure Charge (DSIC) granted for routine infrastructure replacement.
- Imposing a penalty on Cal-Am for repeated violations of the notice requirement of Commission Rule 24.

DRA nevertheless recommends modifications to the Proposed Decision, including:

- Requiring additional documentation when Cal-Am files its quarterly Advice Letters for the DSIC.
- Requiring the one-time filing of a tariff that describes the procedures, numerical formulas, customer safeguards, and any requirements associated with implementing the DSIC.
- Clarification of what constitutes “non-individual projects” in the context used by the Proposed Decision.
- Increasing the amount of the penalty for Rule 24 violations to \$110,000.
- Correcting certain errors in the Proposed Decision and accompanying tables.

## **II. BACKGROUND**

This proceeding has been bifurcated into two phases, with the first phase addressing the revenue requirement for Cal-Am’s Los Angeles district, and the second phase addressing rate design. Dealing only with Phase I issues, the Proposed Decision adopts a partial settlement between Cal-Am and DRA regarding revenue requirement, with some modifications, and resolves three issues in Phase I that have remained in dispute: (1) the PD determines that Cal-Am’s return on equity should be reduced if the Commission adopts WRAMs and MCBAs in Phase II; (2) the PD rejects Cal-Am’s proposed Infrastructure System Replacement Surcharge (ISRS), but adopts a DSIC program with certain requirements, limitations, and customer safeguards, and; (3) the PD imposes a fine of \$11,000 for Cal-Am’s violations of certain Commission notice provisions.

In Phase II of this proceeding, Cal-Am and DRA negotiated a rate design for the Los Angeles district that would implement conservation rates for all customers such that the quantity rates in the summer would be higher than those at other times during the year. Residential customers would also have “inverted block rates” in which the quantity rate increases as consumption amounts increase. In addition, the Phase II settlement would adopt a Water Revenue Adjustment Mechanism (WRAM) for each service area in

Cal-Am's Los Angeles district that decouples revenues from sales. The Phase II settlement would also replace the existing cost balancing accounts for purchased power and purchased water, which only track cost variations due to changes in unit price, with Modified Cost Balancing Accounts that track cost variations due to changes in both unit price and consumption.

### **III. RETURN ON EQUITY (ROE)**

DRA agrees with the Proposed Decision's conclusion that "10.0% is a fair and reasonable ROE for Cal-Am."<sup>1</sup> The Proposed Decision's rejection of the CAPM model advocated by Cal-Am is appropriate and consistent with past Commission practice.<sup>2</sup> DRA also agrees that the Commission's acceptance of Cal-Am's multi-stage DCF model in this proceeding should not foreclose the Commission from considering in other cases other measurements for the constant growth factor.<sup>3</sup> Finally, DRA supports the denial of Cal-Am's request for a leverage adjustment to its ROE.<sup>4</sup>

With regard to WRAM and MCBA, DRA agrees with the PD's determination that, if the Commission adopts the conservation rates and the WRAM and MCBA accounting mechanisms in Phase II,<sup>5</sup> the Commission should also decrease Cal-Am's ROE to reflect the decrease in business risk associated with those mechanisms.<sup>6</sup> The PD reviews Commission case law with regard to revenue adjustment mechanisms in the gas, electric,

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<sup>1</sup> PD at 29.

<sup>2</sup> PD at 27-28.

<sup>3</sup> PD at 27 ("We recognize that in future cases parties may provide other measurements for the constant growth factor, and we will consider those also.").

<sup>4</sup> PD at 29-31.

<sup>5</sup> See Section II, *supra*, for a description of WRAM and MCBA.

<sup>6</sup> Findings of Fact (FOF) 17; Conclusion of Law (COL) 7.

and water utilities, and concludes that the Commission has in fact “explicitly reflected” the reduced risk associated with these mechanisms in the adopted ROEs.<sup>7</sup>

The Proposed Decision notes that the appropriate level of ROE adjustment is “a matter of informed judgment,” and looks to the Commission’s past determination to lower ROE by .2% when it allowed water companies to temporarily record sales losses in a memorandum account during a severe water drought.<sup>8</sup> The PD then finds that the WRAM and MCBA mechanisms under consideration in this proceeding go further in reducing risk than in the drought proceeding, and thus concludes that an ROE adjustment of .5% is appropriate.<sup>9</sup> While DRA has recommended that the decrease in ROE range between 1.56% and 3.28%, there is nevertheless merit in the Proposed Decision’s conclusion that “a .50% ROE adjustment is sufficient for an initial reduction.”<sup>10</sup>

#### **IV. DISTRIBUTION SYSTEM INFRASTRUCTURE CHARGE (DSIC)**

##### **A. DRA Supports The Proposed Decisions’ Limitations On The DSIC**

DRA supports the Proposed Decision’s finding that Cal-Am’s proposed Infrastructure System Replacement Surcharge (ISRS) should not be adopted because Cal-Am has not proven its need for the ratemaking mechanism, and because the ratemaking mechanism poses “substantial risks to ratepayers.”<sup>11</sup> DRA also agrees that, if an infrastructure surcharge is nevertheless granted, it should be subject to requirements that maintain a high level of regulatory oversight because “the record provides strong evidence that the existing level of regulatory oversight for Cal-Am’s Los Angeles District

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<sup>7</sup> PD at 34-39.

<sup>8</sup> PD at 37-38.

<sup>9</sup> PD at 40-41.

<sup>10</sup> PD at 41 (emphasis added).

<sup>11</sup> FOFs 18, 19, and 20.

is necessary to protect ratepayers from paying significantly higher rates for the same capital projects.”<sup>12</sup>

The Distribution System Infrastructure Charge (DSIC) program that the Proposed Decision establishes for Cal-Am contains several important limitations, including:

- The DSIC is only adopted as a pilot program subject to “full review” in the next GRC;<sup>13</sup>
- Cal-Am is directed to “explicitly address infrastructure replacement in its capital asset planning process,” and to revise its 2008 Comprehensive Planning Study (CPS) to include specific planning parameters proposed by DRA;<sup>14</sup>
- The DSIC for this rate case period can only include “the infrastructure projects reviewed and approved in this proceeding;”<sup>15</sup>
- The DSIC for the entire GRC period cannot exceed 7% of annual adopted revenues;<sup>16</sup>
- The advice letters for implementing the DSIC surcharge on ratepayers are subject to the full advice letter protest period, will be reviewed by the Water Division according to specific criteria, and must be approved by Commission resolution, and;<sup>17</sup>
- The advice letters must explain and provide documentary support (1) if the DSIC includes any projects that were not approved in this GRC, and; (2) if the cost of a project exceeded the amount authorized in this GRC.<sup>18</sup>

DRA supports these requirements because they will ensure ongoing regulatory oversight during this rate case period, as well as generate valuable information to determine whether a DSIC is appropriate for other districts and other water companies.

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<sup>12</sup> PD at 52.

<sup>13</sup> PD at 54.

<sup>14</sup> PD at 56-57.

<sup>15</sup> COL 8.a.

<sup>16</sup> PD at 55; COL 8.a.

<sup>17</sup> PD at 55-56; COL 8.b and c.

<sup>18</sup> PD at 56; COL 8.b.



## **B. DRA Proposes Modifications To The DSIC In The Proposed Decision**

### **1. Additional Requirements for DSIC Advice Letter**

In addition to the Proposed Decision's requirements regarding the quarterly filing of an Advice Letter for the DSIC, DRA recommends that the Commission require Cal-Am to provide with its Advice Letter sufficiently detailed supporting documentation that enables the Water Division (and DRA) to confirm, prior to the customer surcharge appearing on the bills, that: (a) projects for which the surcharge is being calculated have been completed and placed into operation, and; (b) the amounts for the quarterly DSIC surcharge were calculated correctly.

### **2. Documenting the DSIC in Cal-Am's Tariff**

When other states have adopted DSIC mechanisms, implementation of the mechanism has only occurred after the specific processes and procedures appropriate for the mechanism have been established through a rulemaking proceeding and/or workshops.<sup>19</sup> If and when the Commission adopts a DSIC-like mechanism for other Cal-Am districts and Class A water utilities, DRA urges the Commission to similarly establish through a rulemaking and/or workshops the appropriate processes and procedures for implementing a DSIC.

Until such time, however, the Commission should require Cal-Am to document the specific mechanism, procedures, and safeguards of the DSIC that the Commission adopts by describing them in a tariff schedule or supplement. Using a tariff schedule or supplement to memorialize adopted DSIC procedures is consistent with the practices of other states. Such a tariff should articulate the key components of the DSIC mechanism by including appropriate excerpts from the final decision and the evidentiary record. For example, if Cal-Am's application contains certain details of the adopted DSIC that have

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<sup>19</sup> See <http://www.state.in.us/legislative/iac/T01700/A00060.PDF> (at page 15 of 42); <http://www.pabulletin.com/secure/data/vol26/26-37/1559.html>; <http://www.unitedwater.com/uwpa/pdfs/MasterTariff.pdf> (at page 59 of 63), and; <http://delcode.delaware.gov/sessionlaws/ga141/chp138.shtml>

been referenced in the record, but have not been otherwise spelled out elsewhere, those details should be contained in Cal-Am's one-time tariff describing the DSIC. The tariff should include the following:

1. A statement of purpose and applicability, and definitions of terms;
2. Descriptions and definitions of the categories of plant eligible for inclusion in a DSIC, by account number and type;
3. The formulas for calculating the fixed costs that are collected via the customer surcharge, and;
4. The DSIC requirements, procedures, and customer safeguards.

DRA recommends that the Commission require Cal-Am to file such a tariff schedule on a one-time basis within 60 days of the final decision, after consultation with DRA and the Water Division.

### **3. Additional Ordering Paragraphs**

DRA agrees with the safeguards recommended by the Commission as discussed above. In addition, DRA recommends that Cal-Am also be required to do the following:

1. Supplement the information that the company presently includes in its annual report to the Commission with:
  - a. Data detailing the revenues collected and the expenses incurred under the DSIC, and the actual amount of infrastructure replaced or rehabilitated using the DSIC compared to that authorized by the Commission in this GRC.
2. Provide interest to ratepayers if the company has over-recovered revenue during the operation of the DSIC. This interest should be at the 90-day commercial paper rate, and should be refunded to ratepayers after the next GRC during which a DSIC reconciliation occurs.
3. In addition to requiring that the company designate on its customer bills that the surcharge is a DSIC,<sup>20</sup> Cal Am should provide notifications to customers in the form of a bill insert and a public notice (published in newspapers) prior to initiating the first surcharge.
4. Provide for a "circuit breaker" that would "turn off" the DSIC and revert to the existing ratesetting mechanisms in the event that the company's rate of return exceeds its authorized rate of return. This is necessary because, if

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<sup>20</sup> PD at 56.

the company is exceeding its authorized rate of return, it clearly has ample funding in the adopted revenue requirement to address the fixed costs targeted by the DSIC. Until the next GRC, the company would then be allowed recovery only through the existing ratemaking process of filing an advice letter and obtaining a ratebase offset.

#### **4. Clarification of “Non-Individual Projects”**

The Proposed Decision includes a footnote regarding “non-individual projects” that Cal-Am proposes be part of its proposed ISRS.<sup>21</sup> The footnote states, in part:

We note here that the non-individual projects under Cal Am’s ISRS proposal, which are approximately 40% of the total ISRS projects, are less vigorously contested by DRA. If the Commission does choose to adopt an ISRS as an alternative to this proposed decision, this is the only set of projects that the record could justify as a pilot ISRS project, with the additional safeguards addressed by DRA...

While DRA continues to question the need for Cal-Am’s proposed ISRS, or even the Proposed Decision’s DSIC, DRA agrees with this footnote that only “non-individual projects” should be contained in any pilot program that adopts an ISRS defined by Cal-Am, rather than the DSIC described in the Proposed Decision. DRA recommends clarifying the footnote by adding the underlined language as follows:

We note here that the non-individual projects under Cal Am’s ISRS proposal, which are approximately 40% of the total ISRS projects, are less vigorously contested by DRA. If the Commission does choose to adopt an ISRS as an alternative to this proposed decision, this is the only set of projects that the record could justify as a pilot ISRS project, with the additional safeguards addressed by DRA. The non-individual projects are those projects such as Cal Am’s recurring projects (RP) that have been previously justified and organized under a set of decision criteria such as for example, “small main replacement”, “pump equipment improvement” or “meters – replacement.” ....

This addition more clearly defines the “non-individual projects” being discussed in the footnote.

## V. PENALTIES

DRA supports the Proposed Decision's conclusion that CAW's violations of the notice provisions of Rule 24 of the Commission's Rules merits a financial penalty. Cal-Am provides water in seven districts in California and is one of the largest, if not the largest, water utility regulated by the Commission. Cal-Am has been engaged in general rate cases before the Commission for decades. Nevertheless, for its Los Angeles rate cases over a period of 20 years, Cal-Am failed to update its GRC notices by checking the official roster of local entities published by the Secretary of State as required by Rule 24.

While the Proposed Decision acknowledges the seriousness and long duration of Cal-Am's repeated notice failures, it nevertheless imposes a penalty of only \$11,000.<sup>22</sup> DRA is concerned that the amount of this penalty is de minimus from the perspective of Cal-Am's management such that it will not serve as an effective deterrent. Per the Proposed Decision, the adopted 2007 revenue for Cal-Am's Los Angeles district is \$19,102,900.<sup>23</sup> While DRA has recommended a fine of \$110,000, even this penalty would amount to only 0.60% of the district's annual revenue. While DRA agrees with the Proposed Decision's statement that, contrary to Cal-Am's claims, "a fine is effective in sending a clear message to all utilities that failure to properly notice rate increases is a matter the Commission takes very seriously,"<sup>24</sup> the Proposed Decision's determination to impose a fine of \$11,000, or 0.06% of the district's annual revenue, does not accomplish that goal.

Regardless of the amount of the penalty imposed, DRA emphasizes that the Commission must ensure that the amount remitted by Cal-Am is charged to shareholders, rather than ratepayers. The Commission should therefore specify that Cal-Am must put

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<sup>21</sup> PD at 53, note 73.

<sup>22</sup> PD at 61-63.

<sup>23</sup> PD, Attachment 3, at 10 of 22.

<sup>24</sup> PD at 62-63.

the penalty amount into Account 538, described as “Miscellaneous Income Deductions,” of the Uniform System of Accounts. Amounts in this account are for expenditures for which the utility will not be reimbursed.<sup>25</sup>

## **VI. CORRECTIONS TO PROPOSED DECISION**

DRA has identified some numerical errors in the Proposed Decision and recommends the following corrections.

- Attachment 1 to the Proposed Decision is identified at the top as a “Summary of Capital Projects Included In Rate Base If ISRS Is Not Adopted.” It is DRA’s understanding that this summary reflects capital projects in rate if a DSIC is adopted.
- Also on Attachment 1, there is an error in the amount listed for one of the projects in the first table (which identifies ISRS projects). In the second column labeled “Additions,” the year 2008 amount for Project 05500513 (a Baldwin Hills project) is listed as \$596,072, but should be changed to \$648,900.<sup>26</sup> This correction changes the ISRS IP Total (or DSIC IP Total) to \$1,056,500, and the ISRS Grand Total (or DSIC Grand Total) to \$2,045,500.
- On page 53, the Proposed Decision states that “the capital projects Cal-Am requests be placed under ISRS [DSIC] total \$2,488,098 for 2007 and \$3,020,272 for 2008.” The amount for 2008 should be \$2,045,500 to reflect the corrected ISRS Grand Total (or DSIC Grand Total) from Attachment 1.
- On pages 16-17, the Proposed Decision states that “The amended settlement tables incorporate this revised cost of debt of 6.36% for 2007, 2008, and 2009; this is a reduction of .63 each year” (footnote omitted). It appears that .63 is a calculation error that should be .53 (6.89% from the settlement minus 6.36% from the amended settlement).

## **VII. CONCLUSION**

DRA urges the Commission to modify the Proposed Decision as discussed above.

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<sup>25</sup> See Uniform System of Accounts for Water Utilities (Class A) (effective January 1, 1955) at 78.

<sup>26</sup> Exhibit 45 (Cal-Am and DRA Settlement Agreement on the Revenue Requirement dated June 23, 2006) at 17, Section 4.8(f) (“Garth Reservoir”).

Respectfully submitted,

/s/ NATALIE D. WALES

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May 29, 2007

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**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of “**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON PHASE ONE PROPOSED DECISION**” in **A.06-01-005** by using the following service:

[ X ] **E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

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Executed on **May 29, 2007** at San Francisco, California.

\_\_\_\_\_  
/s/ ALBERT HILL

Albert Hill

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